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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
INC., AN ARIZONA CORPORATION, FOR
AUTHORITY TO IMPLEMENT ARSENIC
COST RECOVERY MECHANISMS FOR ITS
AGUA FRIA WATER, SUN CITY WEST
WATER, HAVASU WATER, AND TUBAC
WATER DISTRICTS.

Docket No. W-01303A-05-0280

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
INC., AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS SUN CITY
WEST WATER AND WASTEWATER
DISTRICTS.

Docket No. WS-01303A-02-0867

Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
INC., AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS MOHAVE
WATER DISTRICT AND ITS HAVASU
WATER DISTRICT

Docket No. W601303A-02-0869

NOTICE OF FILING RUCO'S REPORT
ON STEP TWO ARSENIC FILING -
HAVASU DISTRICT

1 IN THE MATTER OF THE APPLICATION OF
2 ARIZONA-AMERICAN WATER COMPANY,
3 INC., AN ARIZONA CORPORATION, FOR A
4 DETERMINATION OF THE CURRENT FAIR
5 VALUE OF ITS UTILITY PLANT AND
6 PROPERTY AND FOR INCREASES IN ITS
7 RATES AND CHARGES BASED THEREON
8 FOR UTILITY SERVICE BY ITS ANTHEM
9 WATER DISTRICT, ITS AGUA FRIA WATER
10 DISTRICT, AND ITS ANTHEM/AGUA FRIA
11 WASTEWATER DISTRICT.

Docket No. WS-01303A-02-0870

7
8 **NOTICE OF FILING RUCO'S REPORT ON**
9 **STEP TWO ARSENIC FILING - HAVASU DISTRICT**

10 On April 14, 2008, Arizona American Water Company filed its Step Two ACRM filing
11 for its Havasu Water District, seeking a surcharge of \$2.85 to the monthly minimum
12 charge, and \$0.2885 per 1,000 gallons to the commodity rate.

13 The Residential Utility Consumer Office ("RUCO") hereby files its Report on its audit
14 of the ACRM filing. RUCO recommends a surcharge of \$1.85 to the monthly minimum
15 charge and \$0.1878 per 1,000 gallons to the commodity rate.

16 RESPECTFULLY SUBMITTED this 8th day of July 2008.

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19 
20 Daniel W. Pozefsky
21 Chief Counsel
22
23
24

1 AN ORIGINAL AND NINETEEN
2 COPIES of the foregoing filed this
3 8th day of July 2008 with:

4 Docket Control
5 Arizona Corporation Commission
6 1200 West Washington Street
7 Phoenix, Arizona 85007

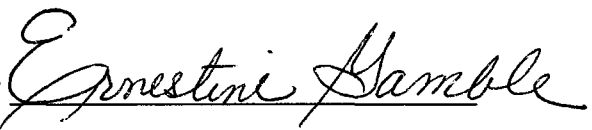
8 COPY of the foregoing hand delivered/
9 mailed this 8th day of July 2008 to:

10 Teena Wolfe
11 Administrative Law Judge
12 Arizona Corporation Commission
13 1200 West Washington Street
14 Phoenix, Arizona 85007

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24 Thomas M. Broderick, Manager
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Phoenix, Arizona 80024

MEMORANDUM

TO: Stephen Ahearn, Director
Marylee Diaz Cortez, Chief of Accounting & Rates
Dan Pozefsky, Legal Counsel

FROM: Tim Coley, Public Utilities Analyst V

RE: Report on RUCO's audit of the Arizona-American Water Company filing for an Arsenic Cost Recovery Mechanism ("ACRM") Step 2 rate increase for its Havasu Water system.

AUDIT OBJECTIVE: The purpose of this audit was to verify the operation and maintenance ("O&M") expenses associated with the pre-approved filing of the ACRM Step 1 completed arsenic plant in Arizona-American's Havasu Water District for the ongoing and recurring annual O&M costs that are stipulated in Commission Decision Nos. 66400, 68310, and 69162.

AUDIT STEPS: The following audit steps and procedures were performed:

- 1) Verified that all schedules that are required by Decision No. 66400 were included in the Company's application.
- 2) Reviewed the "Earnings Test" for compliance, accuracy, and determined if the Company was in conformity with it.
- 3) Reviewed all arsenic O&M invoices, looking for such things as misallocations, unreasonable costs, and non-arsenic O&M costs.
- 4) Verified accuracy of invoice totals.
- 5) Reviewed the "Revenue Requirement" calculations for accuracy and compliance.
- 6) Reviewed the "Rate Design" for accuracy of calculations, checked the reasonableness of the billing determinants by comparing to the previous rate case, and made any necessary adjustments as warranted.

AUDIT FINDINGS: With the one exception as follows, the Havasu ACRM filing is accurate and compliant with Decision Nos. 66400, 68310, and 69162:

Stephen Ahearn, Director
Marylee Diaz Cortez, Chief of Accounting and Rates
Dan Pozefsky, Legal Counsel

- 1) Contrary to Decision No. 68310¹, the Company is requesting recovery of additional arsenic plant in its Step 2 ACRM filing. Under Decision No. 68310 the Company is authorized to recover only O&M costs and not capital costs associated with additional arsenic plant that should have been included in the Company's Step 1 ACRM filing. Decision No. 68310 authorizes the implementation of an ACRM to the extent described within the Order.

In addition, page 8 of Decision No. 68310, a Company representative, Mr. Broderick, describes in-depth what costs would be recoverable in each of the two-steps of the ACRM filings as follows: Item a) on page 8 states: "In the step one filing...the Company could seek rate recovery of capital costs for arsenic treatment facilities that are *up and running*... Item c) on page 8 states: "In the second step filing,...the Company could seek recognition of the prior 12 months of deferred O&M costs, as well as ongoing O&M costs." Commission Decision No. 69162 relinquished the Company's ability to recover any deferred O&M costs until the next rate case for the Havasu system,² which the Company's ACRM Step 2 filing adhered.

AUDIT RECOMMENDATIONS: The Company's ACRM request should be adjusted to remove the request for any recovery of additional arsenic plant in service not recovered by the existing Step 1 ACRM Surcharge and only reflect the recovery of the eligible on-going arsenic O&M costs. This recommended adjustment and the resultant RUCO recommended ACRM Step 2 rate increase are displayed on the following attached Schedule RUCO ACRM-1 and 2.

¹ Arizona Corporation Commission Decision No. 68310, page 7, paragraph 11, section 6 states "Recoverable O&M costs would include only media replacement or regeneration, media replacement or regeneration service, and waste disposal."

² Arizona Corporation Commission Decision No. 69162, page 4, paragraph 8, lines 25-28.

RUCO ADJUSTMENT TO ACRM - HAVASU WATER DISTRICT

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] RUCO ADJUSTMENT	[C] RUCO AS ADJUSTED
1	Arsenic Plant Revenue Requirement			
	Arsenic Plant in Service/Rate Base Net of AIF	\$ 352,946	\$ (352,946)	\$ -
	Accumulated Depreciation Of Arsenic Plant (Step 1)	(21,701)	21,701	-
2	Net Arsenic Plant in Service/Rate Base	\$ 331,245	\$ (331,245)	\$ -
3	Depreciation rate	3.48%		
4	Depreciation expense	12,271	(12,271)	-
5	Depreciation expense net of tax savings ¹	7,535	(7,535)	-
6	Recoverable O&M costs - Ongoing	88,300	-	88,300
7	Recoverable O&M costs - Ongoing Net Of Tax Savings	54,217	-	54,217
8	Arsenic Operating Income	\$ (61,752)		\$ (54,217)
9	Rate of return	-17.50%		
10	Required Rate of Return ²	6.50%		
11	Required Operating Income	21,531	(21,531)	-
12	Operating Income deficiency	83,283		54,217
13	Gross revenue conversion factor ²	1.62863	-	1.62863
14	Revenue deficiency	\$ 135,638	\$ -	\$ 88,300

¹ 38.5986 % tax rate per Dec. 67093

² Decision No. 67093

COMPANY PROPOSED

RATES	CURRENT RATES FOLLOWING ACRM STEP 1	PROPOSED ACRM STEP 2 BASE SURCHARGE	PROPOSED ACRM STEP 2 DEFERRED O&M SURCHARGE	TOTAL PROPOSED
Basic Monthly Minimum Service Charge				
5/8" Meter	\$ 17.40	\$ 2.85	\$ -	\$ 20.25
Commodity Rates Per 1,000 Gallons				
0 to 4,000 gallons	\$ 1.6802	\$ 0.2885	\$ -	\$ 1.9687
4,000 to 13,000 gallons	2.1852	0.2885	-	2.4737
13,000 gallons and over	2.5002	0.2885	-	2.7887

RUCO PROPOSED

RATES	CURRENT RATES FOLLOWING ACRM STEP 1	PROPOSED ACRM STEP 2 BASE SURCHARGE	PROPOSED ACRM STEP 2 DEFERRED O&M SURCHARGE	TOTAL PROPOSED
Basic Monthly Minimum Service Charge				
5/8" Meter	\$ 17.40	\$ 1.85	\$ -	\$ 19.25
Commodity Rates Per 1,000 Gallons				
0 to 4,000 gallons	\$ 1.6802	\$ 0.1878	\$ -	\$ 1.87
4,001 to 15,000 gallons	2.1852	0.1878	-	2.37
15,001 gallons and over	2.5002	0.1878	-	2.69

	[A]	[B]	[C]	[D]	[E]	[F]	[G]	[H]
Line No.	Growth	Customers	Total Gallons Sold Per Cust.	Estimated Average Customers	Monthly Minimum	Minimum Multiples	Equivalent Meters	Fixed Increment Monthly Annual Total
1	Dec. 2006 (Year 1)	1,507	225,336	1,436	1.85	1.0	1,436	\$ 1.85 \$ 31,938
2	Dec. 2007 (Year 2)	1,528	244,777	39	1.85	1.0	39	\$ 1.85 \$ 859
3	Year 2 minus Year 1	21	19,441	7	3.19	1.7	13	\$ 3.19 \$ 280
4	Percentage Change	1.39%	10.67	-	4.52	2.4	-	\$ 4.52 \$ -
5	Avg Gallons (Col B Ln 1 + Col B Ln 2 + 2)		235,057	17	6.27	3.4	57	\$ 6.27 \$ 1,258
6				7	8.54	4.6	34	\$ 8.54 \$ 749
7				1	10.80	5.8	6	\$ 10.80 \$ 135
8				-	37.22	20.1	-	\$ 37.22 \$ -
9				-	71.98	38.8	-	\$ 71.98 \$ -
10	Meter Size							
11	Resid. 5/8-inch	1,426	1,446	1	40.77	22.0	23	\$ 40.77 \$ 511
12	Commer. 5/8-inch	38	39	1	51.89	28.0	29	\$ 51.89 \$ 650
13	1-inch	7	7	1	59.31	32.0	33	\$ 59.31 \$ 743
14	1.5-inch	-	-	1	60.23	32.5	34	\$ 60.23 \$ 755
15	2-inch	17	17	1	62.09	33.5	35	\$ 62.09 \$ 778
16	3-inch	7	7	1	82.47	44.5	46	\$ 82.47 \$ 1,034
17	4-inch	1	1	1	94.52	51.0	53	\$ 94.52 \$ 1,185
18	6-inch	-	-	1	119.54	64.5	67	\$ 119.54 \$ 1,498
19	8-inch	-	-	1	141.78	76.5	80	\$ 141.78 \$ 1,777
20	Multi-family 044 1"	1	1	1			1,985	\$ - \$ -
21	Multi-family 056 2"	1	1	1				\$ - \$ -
22	Multi-family 064 4"	1	1	1				\$ - \$ -
23	Multi-family 065 2"	1	1	1				\$ - \$ -
24	Multi-family 067 4"	1	1	1				\$ - \$ -
25	Multi-family 089 1"	1	1	1				\$ - \$ -
26	Multi-family 102 2"	1	1	1				\$ - \$ -
27	Multi-family 129 4"	1	1	1				\$ - \$ -
28	Multi-family 153 4"	1	1	1				\$ - \$ -
29	Total	1,506	1,527	1,516				\$ - \$ -
30								
31								
32	Calculation of Surcharge			Minimum Surcharge	Commodity Surcharge			
33	Total costs to be recovered (Rev. Requirement)	\$ 88,300		\$ 44,150	\$ 44,150			
34	Minimum Revenue (Col B Ln 33 + 2)							
35	Commodity Revenue (Col B Ln 33 + 2)							
36								
37	Monthly Increment Per Equivalent Meter							
38	Equivalent Meters (Col F Ln 29 x 12 Months)			23,822				
39								
40	Minimum Surcharge (Col C Ln 34 + Ln 38)			\$ 1.85				
41								
42	Average Gallons (Col B Ln 5)			235,057				
43								
44	Commodity Surcharge (Col D Ln 35 + Ln 42)			\$ 0.1878				